IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 83 of 1994

For Approval and Signature:

HONOURABLE MR.JUSTICE D.A.MEHTA Sd/-

HONOURABLE MS.JUSTICE H.N.DEVANI Sd/-

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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COMMISSIONER OF INCOME TAX - Applicant(s)
Versus
NIJRANG SPECIFIC FAMILY TRUST, - Respondent(s)

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Appearance :
MR TANVISH U.BHATT for Applicant(s) : 1,
MRS SWATI SOPARKAR FOR MR SN SOPARKAR for Respondent(s) : 1,

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CORAM : HONOURABLE MR.JUSTICE D.A.MEHTA
and
HONOURABLE MS.JUSTICE H.N.DEVANI

Date : 27/09/2005

ORAL JUDGMENT

(Per : HONOURABLE MS.JUSTICE H.N.DEVANI)

1 The Income Tax Appellate Tribunal, Ahmedabad Bench 'C' has referred the following question under Section 256(1) of the Income Tax Act,1961(the 'Act') at the instance of the Commissioner of Income Tax, Ahmedabad.

> “Whether, the Appellate Tribunal is right in law and on facts in giving direction to treat the income from compensation under the head income from other sources?”

2 The Assessment Year is 1985-86, for which the relevant accounting period is the year ended on 31/03/1985. The assessee, a trust, was engaged in a business styled as Nijrang Packaging Industries as a proprietor of the said business. By a partnership deed dated 01/06/1984, the assessee trust through one of its trustees became a partner of a firm styled as M/s.Nijrang Packaging Industries with another trust viz., Bhalchandra Trust as the other partner. Under the terms and conditions of the partnership deed, the goodwill of the erstwhile

business was to remain exclusively with the assessee trust. The assessee trust retired from the said partnership with effect from 01/01/1985. Under the terms and conditions of the retirement cum dissolution deed, the assessee trust granted a licence to Bhalchandra Trust to use the name and goodwill of the business. For the use of the name and goodwill, the Bhalchandra Trust was required to pay a monthly compensation of Rs.35,000/- to the assessee trust, irrespective of the fact as to whether the Bhalchandra Trust earned any profit or suffered any loss for running the said business.

3 For three months of the previous year relevant to the Assessment Year 1985-86 i.e., January, February and March the assessee trust received compensation amounting to Rs.1,05,000/-. The assessee claimed that the compensation so received should be assessed under the head 'income from other sources'. However, the Assessing Officer vide order dated 25/02/1988 assessed the said amount under the head 'income from business' while framing assessment

u/s.143(3) of the Act.

4 The assessee carried the matter in appeal before the Commissioner of Income Tax (Appeals), who for the reasons stated in his order dated 08/12/1988 allowed the appeal and directed the Inspecting Assistant Commissioner, to treat the income by way of monthly compensation as income under the head “other sources”.

5 The revenue carried the matter in Appeal before the Tribunal. The Tribunal vide its order dated 30/10/1992 confirmed the order of the CIT (Appeals).

6 Heard Mr. Tanvish U.Bhatt, learned Standing Counsel on behalf of the applicant-revenue and Mrs.Swati Soparkar, learned Advocate on behalf of the respondent-assessee.

7 Mr.Bhatt supported the order of the Assessing Officer and submitted that the income of Rs.35,000/- p.m. was closely related to the assessee's old

business, hence the same was assessable under the head “business income”.

8 Mrs.Soparkar, learned Advocate submitted that the user of the name and goodwill has been allowed as owner and not as a business activity. That, there is no direct nexus between the amount received and the business, hence the same is assessable under the head “income from other sources”.

9 As can be seen from the order of the Tribunal, the Tribunal has confirmed the finding of the CIT (Appeals). Hence, it would be necessary to advert to the finding of the CIT (Appeals). Before the CIT (Appeals) it had been contended on behalf of the assessee that the name and goodwill being an intangible asset, the exploitation of the same cannot be equated with the exploitation of any commercial asset. It was also submitted that the compensation so received did not have any direct nexus with the business carried on by the other trust, and that therefore, the earning of the

stipulated sum cannot be said to be from any business connection in praesenti.

10 The CIT (Appeals) found that as per the Deed of Retirement the appellant trust had divested itself of any right to the business, subject only to the right of compensation for the user of the name and goodwill. That, the income thus accruing to the appellant cannot be treated as a business income. That on retirement the assessee ceased to carry on business, and it was not as if there was any temporary suspension of business. That, the business was no longer under the control of the assessee and that, therefore, it could not be said that there is any nexus between the business and the income received by way of compensation. Accordingly, Commissioner of Income Tax (Appeals) directed the Inspecting Assistant Commissioner to treat the income by way of monthly compensation as income under the head “Other Sources”.

11 In the case of the Commissioner of Income Tax Vs.B.M.Kharwar (1969) 72 ITR 603, the Apex Court has held that if the transaction is embodied in a document, the liability to tax depends upon the meaning and content of the language used in it in accordance with the ordinary rules of construction. In the case of Sultan Brothers Private Ltd. v. CIT (1964) 51 ITR 353 (SC), the Constitution Bench of the Supreme Court while dealing with the question as to whether the rent income was business income taxable under the Indian Income Tax Act,1922 formulated the following principle :

> *"Whether a particular letting is business, has to be decided in the circumstances of each case. Each case has to be looked at from the businessman's point of view to find out whether the letting was the doing of a business or the exploitation of his property by an owner".*

In the case of Universal Plast Ltd. Vs. CIT,

(1999) 237 ITR 454, the Supreme Court has summarised the following propositions of law :

> *"(1) no precise test can be laid down to ascertain whether income (referred to by whatever nomenclature, lease, amount, rents, licence fee) received by an assessee from leasing or letting out of assets would fall under the head "Profits and gains of business or profession";*
>
> *(2)it is a mixed question of law and fact and has to be determined from the point of view of a businessman in that business on the facts and in the circumstances of each case, including true interpretation of the agreement under which the assets are let out;*
>
> *(3)where all the assets of the business are let out, the period for which the assets are let out is a relevant factor to find out whether the*

intention of the assessee is to go out of business altogether or to come back and restart the same;

(4)if only a few of the business assets are let out temporarily, while the assessee is carrying out his other business activities, then it is a case of exploiting the business assets otherwise than employing them for his own use for making profit for that business; but if the business never started or has started but ceased with no intention to be resumed, the assets also will cease to be business assets and the transaction will only be exploitation of property by an owner thereof, but not exploitation of business assets".

12 This Court in the case of CIT vs. New India Industries Ltd. (1993) 201 ITR 208 was called upon to decide the question as to whether the rental income

accruing to the assessee during the relevant assessment year from renting out part of its business premises could be said to be income under the head "Income from house property" or could be said to be income from "Profits and gains of business or profession". This Court after exhaustively reviewing the case law on the subject laid down the following principles :

> *"(i)No general principle could be laid down which is applicable to all cases and each case has to be decided on its own facts and circumstances.*
>
> *(ii)Whether an income falls under one head or another has to be decided according to the common notions of a practical and reasonable man, for the Act does not provide any guidance in the matter.*
>
> *(iii)In each case, what has to be seen is whether the asset is being exploited commercially by the letting out or whether it is being let out for the purpose of enjoying the rent. The*

distinction between the two is a narrow one and has to depend on certain facts peculiar to each case. Pure and simple, commercial assets like machinery, plant, tools, industrial sheds or godowns having high business potential stand on a different footing from assets like land or building.

(iv)If an assessee derived income from a commercial asset which is capable of being used as a commercial asset, then it is income from his business, whether he uses that commercial asset himself or lets it out to somebody else to be used. The asset would not cease to be commercial asset simply because temporarily it was put out of use or it was let out to another person for his use.

(v)So long as the commercial asset is capable of being exploited as such, its income is business income

irrespective of the manner in which the asset is exploited by the owner of the business. He is entitled to exploit it to his best advantage and he may do so either by using it himself personally or by letting it out to somebody else.

(vi)If the commercial asset is not capable of being used as such or as a commercial asset, then its being let out to others does not result in the accrual of business income.

(vii)When the assessee has stopped doing business altogether and when the asset ceases to have the character of business or commercial asset, it becomes a capital asset. Qua such asset, the assessee is not carrying on any business. As the owner of the asset, he may exploit such asset but, in such circumstances, income which he receives is no longer business income but income

from property owned by him and hence, "income from house property".

(viii)When the asset is in the nature of land or building capable of being used for any other purpose and when the assessee ceases to use it as a commercial asset either himself or even through others, the income derived by him by renting out the same would more appropriately fall under the head "Income from house property" as, like any other owner of property, he gets income from that property as owner. In such cases, it is not the factum of his business or commercial activity which brings income to him but it is his investment in property or his ownership of property which brings income to him. In such cases, leasing of property itself is the activity. It is leased with a view to produce income, a transaction quite apart from the

ordinary business activities of the assessee.

(ix)In deciding whether an assessee dealt with its property as owner or as a businessman or as a prudent man of commerce, one must see not the form which it gave to the transaction but to the substance of the matter. It will be essential to find out the user of the property and the character in which that property is used. Ownership of property and leasing it out may be done as a part of business or it may be done as a landowner. Whether it is the one or the other must necessarily depend upon the object with which the act is done. If the dominant object of leasing out is incidental to and for the purposes of the assessee's business, the income would be business income. What has to be discovered is whether the property is subservient to the main business of

the assessee".

13 Adverting to the facts of the present case it would be necessary to refer to certain clauses of the partnership deed dated 1/6/1994 as well as the deed of retirement/dissolution dated 1/1/1985. Clause (1) of the partnership deed reads as under:

> *"(1) The name and style of the Partnership Firm hereby constituted shall be "M/s NIJRANG PACKAGING INDUSTRIES", the goodwill to the business shall continue to belong exclusively to Nijrang Trust and party of the second part shall have no right, title or interest therein during the subsistence of this partnership or on dissolution thereof."*

Clauses (3) & (8) of the deed of retirement cum dissolution read as under :

> *"3. That the party of the First Part Nijrang Specific Trust hereby grants licence to the party of the second Part Shri Bhalchandra Trust to use the name*

and goodwill of the business and the party of the Second Part Shri Bhalchandra Trust undertakes to pay the monthly compensation of Rs.35,000/- (Rupees Thirty five thousand only) for such use. The party of the second part Shri Bhalchandra Trust shall be liable to pay such compensation irrespective of the fact whether hereafter it earns any profits or incurs any losses from the running of the business of M/s.Nijrang Packaging Industries. It is distinctly understood that this compensation is not being paid as a share of business profits earned by the party of the First Part but is being paid as the compensation for the user of the goodwill and therefore, will be payable even in case of loss".

xxx xxx xxx xxx xxx

"8. That the retiring partner has hereafter no interest of any sort in the

said business or the assets and liabilities thereof except the goodwill thereof and the running business (except goodwill) liabilities hereafter belongs to the party of the second part as a sole owner thereof".

14 From a plain reading of the clauses mentioned above, it is apparent that upon formation of partnership the goodwill of the business continued to belong exclusively to the assessee trust. Upon retirement from the partnership, the assessee trust ceased to carry on business and permitted the other trust i.e. Bhalchandra Trust to use the name and goodwill for a monthly compensation of Rs.35,000/-. It is also clear that there was no nexus between the compensation paid and the business profits earned by the other trust.

15 Applying the principles laid down by the decision of this Court in the case of CIT Vs. New India Industries Ltd.(supra) to the facts of the

present case, it is apparent that the case of the assessee is squarely covered by Principle No. (vii) of the principles enumerated therein. Thus, the assessee having stopped doing business altogether, the assets viz., name and the goodwill, cease to have the character of business or commercial assets, and become capital assets. Thus, when the assessee exploits the said asset as an owner, the income received therefrom is no longer “business income” but assumes the character of “income from other sources”.

16 Both the CIT (Appeals) as well as the Tribunal have upon appreciation of evidence and reading of the Terms of the deeds, recorded concurrent findings of facts and arrived at a conclusion which is in consonance with the principles laid down by the decisions cited above. In the circumstances, it is not possible to find any infirmity in the order of the Tribunal in holding the income from compensation to be assessable under the head “Income from other sources”.

17 The Reference is accordingly answered in the affirmative i.e. in favour of the assessee and against the revenue. The reference stands disposed of accordingly with no order as to costs.

Sd/- Sd/-

(D.A.Mehta, J) (H.N.Devani, J)

m.m.bhatt